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\* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

+ **FAO(OS) (COMM) 35/2023 & C.M. APPL.Nos.8573-8574/2023**

**SKYLINE AIR CONDITIONING**

**ENGINEERS PRIVATE LIMITED**

..... Appellant

Through: Mr. Jaspreet Singh, Advocate

versus

**PUBLIC WORKS DEPARTMENT**

..... Respondent

Through: None

Date of Decision: 21<sup>st</sup> February, 2023

**CORAM:**

**HON'BLE MR. JUSTICE MANMOHAN**

**HON'BLE MR. JUSTICE SAURABH BANERJEE**

**J U D G M E N T**

**MANMOHAN, J (ORAL):**

1. Present appeal has been filed challenging the order dated 16<sup>th</sup> February, 2023 passed by the learned Single Judge in OMP (I) (COMM) 51/2023, whereby the petition of the Appellant under Section 9 of the Arbitration and Conciliation Act, 1996 has been dismissed
2. Learned counsel for the Appellant states that the Respondent had called for tender for the maintenance work at Ch. Brahm Prakash Ayurved Charak Sansthan, Khera Dabar, Najafgarh, Delhi for the period 2022-23 and 2023-24. The same was awarded to the Appellant for a sum of Rs.4,74,24,939/-. He states that the Respondent without following the due process of law and principles of natural justice, terminated the underlying Agreement vide termination notice dated 07<sup>th</sup> February, 2023. He states that though the Respondent has terminated the Agreement with the Appellant as per Clause 3 thereof, however as Clause 3 provides for various sub-clauses it

is not clear under which sub-clause has the said Agreement been terminated by the Respondent.

3. Learned counsel for the Appellant contends that the learned Single Judge has failed to consider that fraud was played by the Respondent since the tender was for comprehensive maintenance, day-to-day repair etc. but the Respondent has claimed upgradation and renovation from the Appellant without paying extra cost to the Appellant. He states that the Respondent has failed to comply with its obligations under the said tender as it has not provided eight lifts in working condition.

4. Learned counsel for the Appellant further states that the learned Single Judge has failed to consider that in the termination notice or the letter dated 13<sup>th</sup> February, 2023 given to the Bank for the invocation of the Performance Bank Guarantee, no reason, sum or basis has been mentioned, whereas the same should have been mentioned in terms of Clause- 3 of the Performance Bank Guarantee. In support of his submission, he relies upon the judgments of this Court in *Ansal Properties & Industries (P) Ltd. vs. Engineering Projects (India) Ltd.* 1997 (41) DRJ 618, *Puri International (P) Ltd. vs. National Building Constructions Co.Ltd.* MANU/DE/0650/1997 and *Marshal Infradevelopers India Pvt. Ltd. vs. Union of India & Ors.* MANU/DE/1047/2022.

COURT'S REASONING

ENCASHMENT OF BANK GUARANTEE CAN BE STAYED ON TWO GROUNDS ONLY NAMELY, FRAUD AND IRRETRIEVABLE INJUSTICE/INJURY.

5. It is settled law that encashment of bank guarantee can be stayed on two grounds only namely, fraud and irretrievable injustice/injury. In *Andhra*

***Pradesh Pollution Control Board vs. CCL Products (India) Limited, 2019***

**SCC OnLine SC 985**, the Supreme Court has held as under:-

“23. The settled legal position which has emerged from the precedents of this Court is that absent a case of fraud, irretrievable injustice and special equities, the Court should not interfere with the invocation or encashment of a bank guarantee so long as the invocation was in terms of the bank guarantee.”

(emphasis supplied)

6. As far as the concept of irretrievable injustice and injury is concerned, the Supreme court in ***Dwarikesh Sugar Industries Ltd. vs. Prem Heavy Engineering Works (P) Ltd. & Anr., (1997) 6 SCC 450*** has held as under:-

“22. The second exception to the rule of granting injunction, i.e. the resulting of irretrievable injury, has to be such a circumstance which would make it impossible for the guarantor to reimburse himself, if he ultimately succeeds. This will have to be decisively established and it must be proved to the satisfaction of the court that there would be no possibility whatsoever of the recovery of the amount from the beneficiary, by way of restitution.”

(emphasis supplied)

7. Consequently, the nature of fraud on the basis of which an encashment of bank guarantee can be stayed is fraud of an egregious nature. It should be a fraud which the bank can detect with minimal investigation. Such is not the case in the present proceedings.

**THE UNDERLYING CONTRACT IS INDEPENDENT FROM THE BANK GUARANTEE ISSUED BY THE BANK.**

8. It has further been held in a catena of cases that the underlying contract is independent of the bank guarantee issued by the bank. The Supreme Court in ***U.P. Cooperative Federation Ltd. vs. Singh Consultants and Engineers (P) Ltd., (1988) 1 SCC 174*** has held as under:-

“19. ....The plaintiffs appealed to the Court of Appeal in England. It was held by a Bench consisting of Lord Denning, M.R., Browne and Geoffrey Lane, L.J. that a performance guarantee was similar to a confirmed letter of credit. Where, therefore, a bank had given a

performance guarantee it was required to honour the guarantee according to its terms and was not concerned whether either party to the contract which underlay the guarantee was in default. The only exception to that rule was where fraud by one of the parties to the underlying contract had been established and the bank had notice of the fraud. Accordingly, as the defendants' guarantee provided for payment on demand without proof or conditions, and was in the nature of a promissory note payable on demand, and the plaintiffs had not established fraud on the part of the buyers, the defendants were required to honour their guarantee on the demand made by the Libyan bank. It followed that the judge had been right to discharge the injunction and that the appeal would be dismissed.

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28. I am, however, of the opinion that these observations must be strictly considered in the light of the principle enunciated. It is not the decision that there should be a prima facie case. In order to restrain the operation either of irrevocable letter of credit or of confirmed letter of credit or of bank guarantee, there should be serious dispute and there should be good prima facie case of fraud and special equities in the form of preventing irretrievable injustice between the parties. Otherwise the very purpose of bank guarantees would be negated and the fabric of trading operation will get jeopardised.

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34. On the basis of these principles I reiterate that commitments of banks must be honoured free from interference by the courts. Otherwise, trust in commerce internal and international would be irreparably damaged. It is only in exceptional cases that is to say in case of fraud or in case of irretrievable injustice be done, the court should interfere.

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44. The modern documentary credit had its origin from letters of credit. We may, therefore, begin the discussion with the traditional letter of credit. Paul R. Verkuil in an article explains the salient features of a letter of credit in these terms:

“The letter of credit is a contract. The issuing party — usually a bank — promises to pay the ‘beneficiary’ — traditionally a seller of goods — on demand if the beneficiary presents whatever documents may be required by the letter. They are normally the only two parties involved in the contract. The bank which issues a letter of credit acts as a principal, not as agent for its customer, and engages its own credit. The letter of credit thus evidences — irrevocable obligation to honour the

*draft presented by the beneficiary upon compliance with the terms of the credit.”*

45. ....The bank must pay if the documents are in order and the terms of credit are satisfied. The bank, however, was not allowed to determine whether the seller had actually shipped the goods or whether the goods conformed to the requirements of the contract. Any dispute between the buyer and the seller must be settled between themselves. The courts, however, carved out an exception to this rule of absolute independence. The courts held that if there has been “fraud in the transaction” the bank could dishonour beneficiary's demand for payment. The courts have generally permitted dishonour only on the fraud of the beneficiary, not the fraud of somebody else.

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49. This was also the view taken by this Court in United Commercial Bank case. There A.P. Sen. J. speaking for the Court, said (pages 323 and 324): (SCC pp. 783-84, paras 40-42)

*“...the rule is well established that a bank issuing or confirming a letter of credit is not concerned with the underlying contract between the buyer and seller. Duties of a bank under a letter of credit are created by the document itself, but in any case it has the power and is subject to the limitations which are given or imposed by it, in the absence of the appropriate provisions in the letter of credit.....*

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53. Whether it is a traditional letter of credit or a new device like performance bond or performance guarantee, the obligation of banks appears to be the same. If the documentary credits are irrevocable and independent, the banks must pay when demand is made. Since the bank pledges its own credit involving its reputation, it has no defence except in the case of fraud. The bank's obligations of course should not be extended to protect the unscrupulous seller, that is, the seller who is responsible for the fraud. But, the banker must be sure of his ground before declining to pay. The nature of the fraud that the courts talk about is fraud of an “egregious nature as to vitiate the entire underlying transaction”. It is fraud of the beneficiary, not the fraud of somebody else. If the bank detects with a minimal investigation the fraudulent action of the seller, the payment could be refused. The bank cannot be compelled to honour the credit in such cases. But it may be very difficult for the bank to take a decision on the alleged fraudulent action. In such cases, it would be proper for the bank to ask the buyer to approach the court for an injunction.

(emphasis supplied)

9. In *Standard Chartered Bank vs. Heavy Engineering Corporation Ltd. & Anr.*, 2019 SCC OnLine SC 1638, the Supreme Court reiterated the aforesaid principle as under:-

*“23. The settled position in law that emerges from the precedents of this Court is that the bank guarantee is an independent contract between bank and the beneficiary and the bank is always obliged to honour its guarantee as long as it is an unconditional and irrevocable one. The dispute between the beneficiary and the party at whose instance the bank has given the guarantee is immaterial and is of no consequence. There are, however, exceptions to this Rule when there is a clear case of fraud, irretrievable injustice or special equities. The Court ordinarily should not interfere with the invocation or encashment of the bank guarantee so long as the invocation is in terms of the bank guarantee.”*

(emphasis supplied)

10. Consequently, at the behest of a contractor i.e. the Appellant, the Court cannot examine the terms of the underlying Agreement entered into between the contractor and beneficiary to determine as to whether the Respondent had wrongly/illegally terminated the underlying agreement.

**BANK GUARANTEE IS UNCONDITIONAL AND UNEQUIVOCAL AS IT INCORPORATES A CONCLUSIVE EVIDENCE CLAUSE**

11. This Court is of the view that it is also essential to determine as to whether the bank guarantee in question is unconditional or not. The relevant terms in the bank guarantee involved herein are reproduced hereinbelow:-

*“3. We, **Bank of India** do hereby undertake to pay the amount due and payable under this guarantee without any demur, merely on a demand from the Government stating that the amount claimed is required to meet the recoveries due or likely to be due from the said contractor. Any such demand made on the Bank shall be conclusive as regards the amount due and payable by the Bank under this Guarantee. However, our liability under this guarantee shall be restricted to an amount not exceeding **Rs.14,22,748 (Rupees Fourteen Lacs Twenty Two Thousand Seven Hundred Forty Eight Only)**.*

*4. We **Bank of India** Further undertake to pay the Government any money so demanded notwithstanding any dispute or disputes raised by the contractor in any suit or proceeding pending before any Court or Tribunal, our liability*

*under this Bank Guarantee being absolute and unequivocal. The payment so made by us under the Bank Guarantee shall be a valid discharge of our liability for payment there under and the contractor shall have no claim against us for making such payment.”*

12. From the aforesaid, it is apparent that the bank guarantee in question is unconditional, unqualified and unequivocal because it incorporates a conclusive evidence clause inasmuch as the bank is liable to pay, without any demur, merely on a demand from the Government stating that the amount claimed is due by way of loss or damage caused by the contractor i.e. appellant and such a demand ‘*shall be*’ conclusive on the bank.

13. This Court is of the view that the manifest object of conclusive evidence clauses is to provide a ready means of establishing the existence and amount of the guaranteed debt and avoiding an enquiry upon legal evidence into the debits going to make up the indebtedness.

**LETTER OF ENCASHMENT OF BANK GUARANTEE IS NOT TO BE READ LIKE A PLAINT OR A STATUTE**

14. This Court is of the view that one must not forget that one is dealing with a commercial transaction between commercial parties, who may or may not be well versed with intricacies of law. Accordingly, the letter of encashment of bank guarantee is not to be read like a Complaint or a Statute. Moreover, one must not lose sight of the larger objective that commitments of banks must be honoured free from interference by the Courts, as otherwise, trust in commerce, internal and international would be irreparably damaged.

15. Accordingly, the present appeal along with pending applications being bereft of merit is dismissed, but no order as to costs.

**MANMOHAN, J**

**SAURABH BANERJEE, J**

**FEBRUARY 21, 2023  
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